ANALYSIS OF ORIGINAL BILL

Author:	Campbell	Analyst:	Marion Mann DeJong	Bill Number:	AB 1169
Related Bills:	See Legislative History	Telephone:	845-6979	Introduced Date:	02/23/2001
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Manufacturers' Investment Credit/Extend to Electric Power Production from Fossil Fuel & Alternate Sources

SUMMARY

This bill would:

- extend the Manufacturers' Investment Credit (MIC) to businesses that generate electricity from fossil fuel or "other" sources for seven years, and
- allow this group of taxpayers to carry forward unused MIC credits indefinitely.

PURPOSE OF THE BILL

The purpose of this bill appears to be to encourage investment in property that generates electricity.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would become effective immediately upon enactment and would be operative for taxable years beginning on or after January 1, 2001, and before January 1, 2008.

POSITION

Pending.

Summary of Suggested Amendments

Amendments are needed to modify the activity test for generation of electricity within the definition of "qualified property," and to define "generation of electricity." See "Implementation Considerations" below. Department staff is available to assist the author with these and any other amendments.

ANALYSIS

FEDERAL/STATE LAW

Existing state and federal laws allow a taxpayer to deduct expenses paid or incurred in the ordinary course of a taxpayer's trade or business. Also, these laws allow a depreciation deduction for the obsolescence or wear and tear of property used in a trade business or held for the production of income.

Board Position:			Department Director	Date
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Existing federal law does not have a credit comparable to the MIC. However, federal law does provide an investment property credit for certain depreciable or amortizable property that qualifies for the rehabilitation, energy, or reforestation credit. The energy credit is 10% of the basis of each energy property placed in service during the tax year. "Energy property" is:

- Equipment that uses solar energy to generate electricity, to heat or cool (or provide hot water for use in) a structure, or to provide solar process heat; or
- Equipment used to produce, distribute, or otherwise utilize energy from a geothermal deposit. In the case of electricity generated by geothermal power, only equipment used up to but not including the electrical transmission stage is "energy property."

Existing federal law also provides a renewable electricity production credit. For 2000, the credit is 1.5 cents per kilowatt hour of electricity produced at a "qualifying facility" by taxpayers from wind, "closed-loop biomass," (generally, organic plants, except timber, grown for the sole purpose of being used to generate electricity), or poultry waste. The electricity must be sold to an unrelated person during the taxable year. The credit is available for a ten-year period beginning with the year the facility is placed in service.

Existing state law allows qualified taxpayers a credit, known as the MIC, equal to 6% of the amount paid or incurred after January 1, 1994, for qualified property that is placed in service in California.

For purposes of the MIC, a qualified taxpayer is any taxpayer engaged in manufacturing activities described in specified codes listed in the Standard Industrial Classification (SIC) Manual, 1987 edition. Qualified property is any of the following:

1) Tangible personal property that is defined in Section 1245(a) of the Internal Revenue Code (IRC) and used primarily:

- for manufacturing, processing, refining, fabricating, or recycling of property;
- for research and development;
- for the maintenance, repair, measurement, or testing of otherwise qualified property; or
- for pollution control that meets or exceeds state or local standards.

2) The value of any capitalized labor costs directly allocable to the construction or modification of the property listed in #1 above or for special purpose buildings and foundations listed in #3 below.

3) For certain taxpayers engaged in specified SIC Code activities, special purpose buildings and foundations.

For taxpayers engaged in computer programming and computer software related activities, qualified property includes computers and computer peripheral equipment used primarily for the development and manufacture of prepackaged software, and the value of any capitalized labor costs directly allocable to such property.

The MIC explicitly excludes certain types of property from the definition of qualified property, such as furniture, inventory, and equipment used in an extraction process.

The MIC may be carried over for a maximum of eight years. For small businesses, this carryover period is extended to ten years. A small business means any taxpayer that at the end of the taxable year that the credit is allowed for that year meets any one of the following requirements:

- Has gross receipts of less than $50 million.
- Has net assets of less than $50 million.
- Has a total manufacturers' investment credit of less than $1 million.
- Is engaged in biopharmaceutical activities or other biotechnology activities that are described in SIC codes 2833 to 2836, inclusive, and which has not received regulatory approval for any product from the USFDA.

THIS BILL

This bill would extend the MIC to taxpayers engaged in businesses relating to the generation of electricity by fossil fuel or "other" sources. These businesses are described in the North American Industry Classification System (NAICS) Manual Codes 221112 and 221119, 1997 edition, as follows:

221112 Fossil Fuel Electric Power Generation

"Establishments primarily engaged in operating fossil fuel powered electric power generation facilities. These facilities use fossil fuels, such as coal, oil, or gas, in internal combustion turbine conventional steam process to produce electric energy. The electric energy produced in these establishments is provided to electric power transmission systems or to electric power distribution systems."

221119 Other Electric Power Generation

"Establishments primarily engaged in operating electric power generation facilities (except hydroelectric, fossil fuel, and nuclear). These facilities convert other forms of energy, such as solar, wind, or tidal power, into electrical energy. The electric energy produced in these establishments is provided to electric power transmission systems or to electric power distribution systems."

The definition of "qualified taxpayer" would be modified to include taxpayers engaged in businesses relating to the generation of electricity by fossil fuel or "other" sources under the NAICS codes referenced above. The definition of "qualified property" would be modified to include property used by taxpayers engaged in businesses relating to the generation of electricity by fossil fuel or "other" sources. The definition of "manufacturing" would be modified to include the generation of electricity.

This bill would modify the carryover provisions to allow taxpayers engaged in businesses relating to the generation of electricity by fossil fuel or "other" sources to carry forward any unused credits indefinitely.

This bill also would make minor technical changes to delete obsolete language referencing the low-emission vehicle credit, specify specific statutes that amended the MIC, and change "which" to "that" in various places.

IMPLEMENTATION CONSIDERATIONS

Although this bill did not provide an activity test for generation of electricity within the definition of “qualified property,” the changes made to the definition of “manufacturing” may allow taxpayers to claim the credit for property used to generate electricity. Adding an activity test for generation of electricity would clarify what property qualifies for the MIC.

The term “generation of electricity” is not defined. Undefined terms can result in disputes between taxpayers and the department.

This bill would add a specific industry to the MIC and then remove that group seven years later. This may cause taxpayer confusion once the group no longer qualifies for the credit. This confusion may be compounded because that group will be allowed to carry forward unused credits indefinitely while other taxpayers are allowed to carry forward unused credits for only eight or ten years.

LEGISLATIVE HISTORY

AB 2461 (Runner 1999/2000) would have (1) increased the MIC from 6% to 7% of the cost of certain property used in manufacturing, (2) extended the credit to certain electric power generation or mineral extraction businesses, and (3) extended the credit indefinitely. AB 2461 was held in the Assembly Revenue and Taxation Committee. *AB 2596 (Corbett 1999/2000)* would have extended the MIC to taxpayers engaged in the generation of electricity using natural gas. AB 2596 was held in the Assembly Appropriations Committee. *SB 1920 (Kelley 1999/2000)* would have extended the MIC to certain electric power generation corporations. SB 1920 was held in the Senate Revenue and Taxation Committee.

AB 45X (Kelley 2001/2002) would extend the MIC to taxpayers engaged in certain electric power generation activities. AB 45X is in the Assembly Appropriations Committee. *AB 96X (Campbell 2001/2002)* would extend the MIC to certain electric power generation businesses. *AB 240 (Runner 2001/2002)* is identical to AB 2461 (Runner 1999/2000). *AB 1276 (Campbell 2001/2002)* is identical to AB 96X.

OTHER STATES’ INFORMATION

Review of *Illinois*, *Massachusetts, Michigan,* and *New York* tax laws found no comparable tax credit for investments in property used to generate electricity like that proposed by this bill. The laws of these states were reviewed because they have credits comparable to the MIC.

FISCAL IMPACT

If the implementation considerations addressed in this analysis are resolved, the department’s costs are expected to be minor.

ECONOMIC IMPACT

Revenue Estimate

Extending the MIC to electric power production from fossil fuels and alternative sources would result in the following revenue losses:

Revenue Impact of AB1169 For Taxable Years Beginning On Or After January 1, 2001 Assumed Enactment After June 30, 2001 (In Millions)		
2001-02	2002-03	2003-04
-$10	-$12	-$12

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this bill.

Revenue Discussion

This estimate is based on data from a U.S. Census Bureau survey of capital expenditures by relevant industries for 1998 and microsimulation models of California tax returns for tax years 1997 and 1998. These numbers were grown to approximate 2001 and beyond. The credit use rates taken from the models were then applied to derive the aggregate credit use. The fiscal year cash flow patterns are based on the department's analysis of how manufacturers adjusted their tax payments to reflect the reduction in liability resulting from the current law MIC.

This estimate does not include losses resulting from qualified taxpayers as defined under current law that might receive additional credit for activities that would qualify under the changes made by this bill. Such losses cannot be quantified since the data and information needed are not available.

ARGUMENTS/POLICY CONCERNS

This bill would expand the definition of manufacturing to include the generation of electricity. As a result, taxpayers that qualify for the MIC under existing law could claim the MIC for existing auxiliary activities that satisfy this expanded definition of manufacturing. For example, a manufacturing plant that includes on its premises a co-generation facility that produces electricity to run the manufacturing line would qualify for the MIC under the revised activity test. Under current law, while this co-generation facility may be assigned the same SIC Code as the manufacturing activity it supports, the costs of the property in the co-generation facility would not qualify for the MIC since the property is not used in a qualified activity.

This bill would benefit transactions for which binding contracts already exist and would not be limited to benefit only future business decisions. Under this bill, any costs paid under the terms of a contract entered into after January 1, 1994, but prior to taxable years beginning on or after January 1, 2001, would qualify for the credit.

This bill would require the department to retain the MIC carryover on the tax forms indefinitely because it would allow an unlimited credit carryover for electric power generation taxpayers. Recent credits have been enacted with a carryover limit since experience shows credits are typically used within eight years of being earned.

LEGISLATIVE STAFF CONTACT

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